A Monthly Report from The Conference Board

INTERNATIONAL ECONOMIC SCOREBOARD

The Conference Board

JUNE, 1987

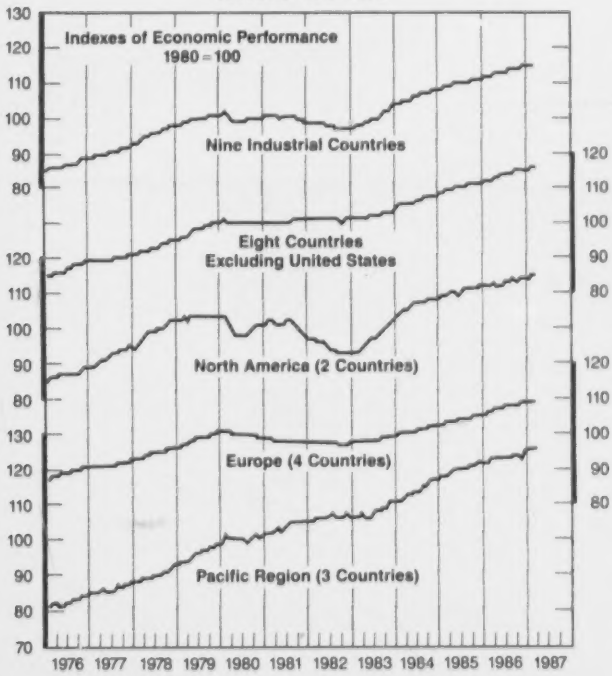
SUMMARY

Although the world business cycle has yet to break out of its pattern of moderate expansion, the leading indexes are signalling vigorous growth ahead for all except two of the nine major industrial countries. The exceptions are Canada and Italy, where only modest growth is indicated. For the nine countries as a group the leading index is rising at a spirited 10 percent annual rate, as compared with 7 percent three months ago, 5 percent six months ago, and 1 percent a year ago. Some of this exuberance is due to stock prices, which have advanced this year in every country except West Germany, but even when stock prices are omitted the leading indexes show gains. Japan, Taiwan, and Australia show the most rapid growth, and the West German leading index is now perking up nicely after months of stability. It remains to be seen whether the fire under the leading indicators will spread, but this is the usual pattern, and Taiwan is setting a good example with a 13 percent growth rate in its economic performance index.

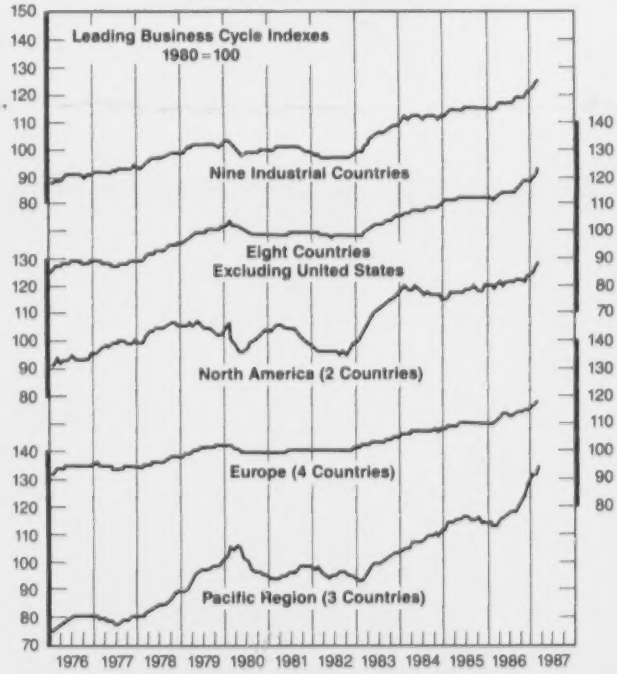
	Ten-year Growth Rate	*Indexes of Economic Performance Growth Rates**			*Leading Business Cycle Indexes Growth Rates**				
	1976-86	*6 mos. ago*	*3 mos. ago*	*Latest month*	*6 mos. ago*	*3 mos. ago*	*Latest month*	*Current Reading on the Cycle*	*Latest Month Covered*
	annual rates, percent								
9 countries	3	3	3	2	5	7	10	Expansion continuing, leaders strong	Mar.
8 countries ex. U.S.	3	3	3	3	5	9	11	Expansion continuing, leaders strong	Mar.
North America (2)	3	2	3	2	4	4	9	Expansion continuing	Mar.
Europe (4)	2	4	3	3	3	4	6	Expansion continuing	Mar.
Pacific Region (3)	4	3	3	3	9	17	20	Expansion continuing, leaders strong	Mar.
United States	3	2	1	2	3	5	8	Expansion continuing	Apr.
Canada	3	2	3	3	2	1	3	Expansion continuing	Mar.
West Germany	2	4	2	3	0	2	6	Expansion continuing	Apr./Mar.
France	2	5	5	3	7	6	9	Expansion continuing	Mar./Apr.
United Kingdom	2	3	4	4	3	3	8	Expansion continuing	Mar.
Italy	2	2	2	1	5	4	4	Expansion continuing	Jan./Mar.
Japan	4	3	2	2	9	18	22	Expansion continuing, leaders strong	Mar.
Australia	3	2	3	4	4	11	12	Expansion continuing, leaders strong	Mar.
Taiwan, R.O.C.	8	13	13	13	13	11	17	Expansion continuing, leaders strong	Apr.

* Ratio of current month's index to average index over the preceding 12 months, expressed as a compound annual rate.

Where We Are


Indexes of Economic Performance
1980=100
Nine Industrial Countries
Eight Countries
Excluding United States
North America (2 Countries)
Europe (4 Countries)
Pacific Region (3 Countries)
1976 1977 1978 1979 1980 1981 1982 1983 1984 1985 1986 1987

Where We're Headed


Leading Business Cycle Indexes
1980=100
Nine Industrial Countries
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North America (2 Countries)
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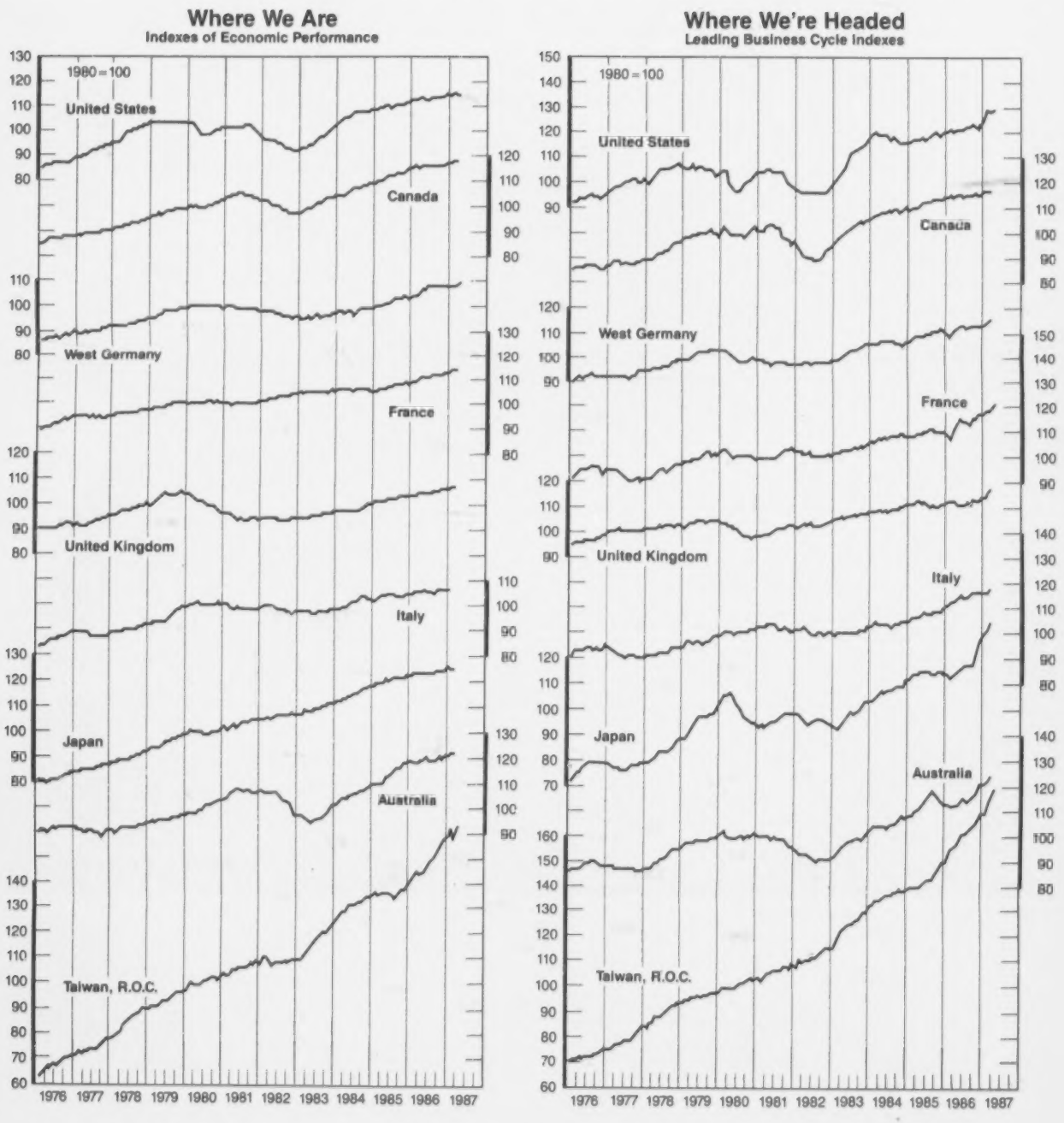
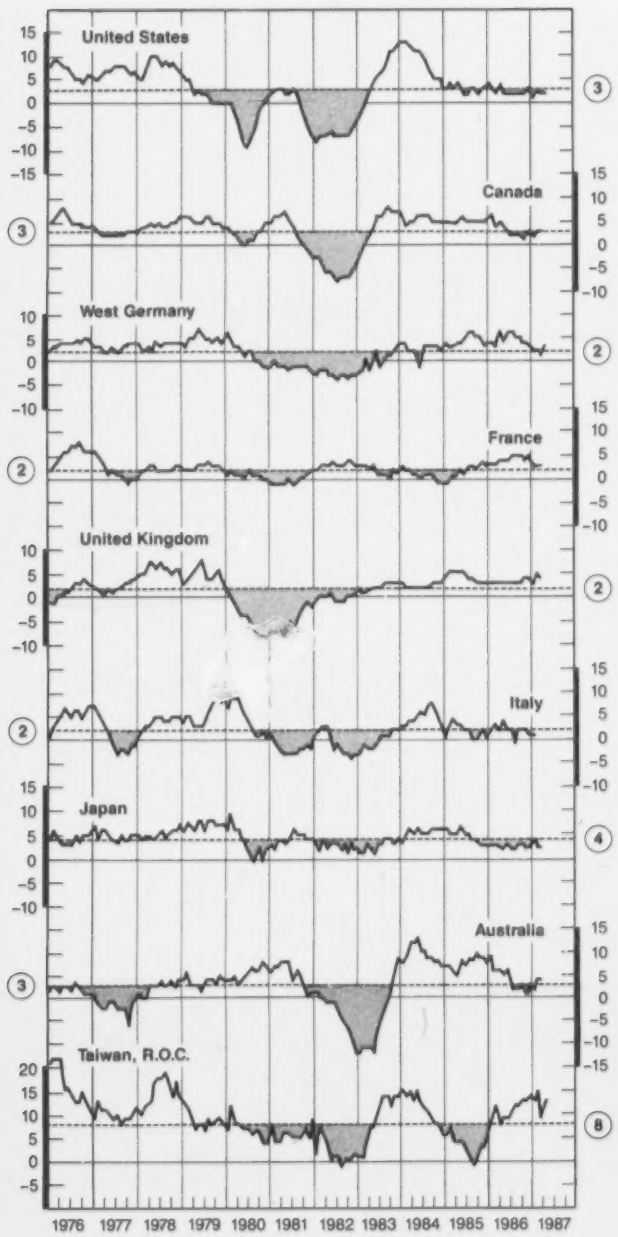


Source: Compiled for The Conference Board by the Center for International Business Cycle Research, Columbia Business School.

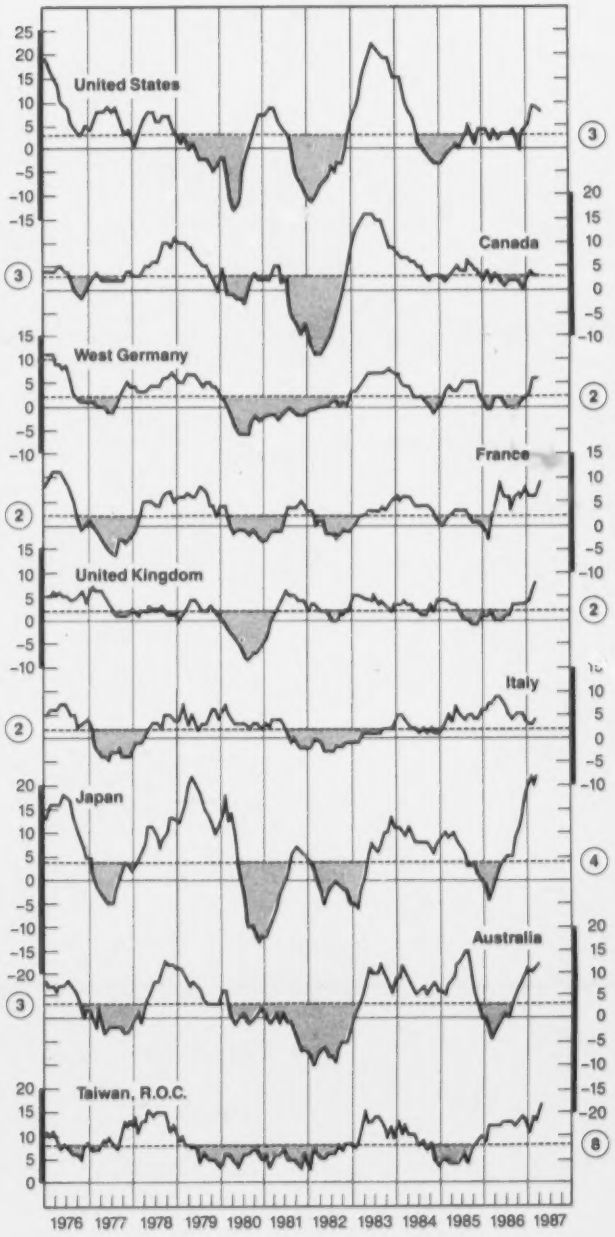
Where We Are

Growth Rates, %, Performance Indexes



Where We're Headed

Growth Rates, %, Leading Indexes



Note: Horizontal dashed lines are average growth rates for 1976-1986 in the index and in Real GNP.

Source: Compiled for The Conference Board by the Center for International Business Cycle Research, Columbia Business School.

FORECASTING THE U.S. TRADE BALANCE IN 1987

Do recent movements in the *Scoreboard's* leading indexes together with the decline in the dollar exchange rate, point to a reduction in the U.S. trade deficit in 1987? To answer this question, let us first take a look at the recent record of these factors in anticipating trade flows.

As *Scoreboard* readers know, the eight-country leading index was developed to track future movements in the world's major industrial economies outside the U.S. When economic activity in the aggregate grows in these countries, their demand for imports usually increases. Thus, growth in their output and income can lead to an increase in U.S. exports to them. Recessions in these economies can, in contrast, lead to a reduction in our exports to them. Since leading indicators are designed to anticipate faster growth, slower growth, or recession, they may also predict trends in U.S. exports.

U.S. Exports, Imports and Trade Balance

Changes in the dollar exchange rate are another factor in this picture. When the U.S. dollar increases in value relative to other currencies, one expects foreign demand for U.S. goods to fall. In contrast, a decline in the relative value of a dollar makes U.S. goods more competitive and one expects the quantity of U.S. exports to increase, although the expectation may not be quickly realized. Tests of the usefulness of the eight-country leading composite and the real exchange rates in predicting U.S. maufactured goods exports, as reported in the December 1986 *Scoreboard*, suggest that both factors are important.

An important distinction must be made between nominal and real dollar exchange rates. Nominal exchange rates are the rates typically quoted in the financial press, while real exchange rates are equal to nominal exchange rates plus an adjustment for inflation differentials between the U.S. and other countries. Because real exchange rates take into account both exchange-rate movments and relative price movements, the real exchange rates should be used in determining trade flows.

Accordingly, in this analysis we use two explanatory variables to predict the percent changes in the constant-dollar volume of U.S. exports: (1) the eight-country leading index for December preceding the forecast year, and (2) the real exchange rate in July preceding the forecast year. The real exchange rate is the 44-country index compiled by Morgan-Guaranty Trust Company. Both explanatory variables are expressed as six-month smoothed rates of change, as used in the *Scoreboard*. Similarly, in forecasting percent changes in imports, which are other countries' exports to the U.S., we use the six-month smoothed change in the *U.S.* leading composite for December preceding the forecast year and the preceding July's growth or decline in the real exchange rate.

The accompanying highlights the principal findings of this forecasting procedure as applied to the physical volume of exports, imports and the trade balance from 1972 to 1987. Given the simplicity of the analytical appartatus relative to the large task assigned to it, the forecasts are fairly good. Not surprisingly, however, some anomalies exist for individual years. For example, as the chart shows, exports were predicted to increase to 5 percent in 1986 whereas they actually fell by one percent. The correlation coefficient shows that 58 percent of the 1972-86 variation in the growth of exports was accounted for by the two factors.

For 1987, the volume of exports is expected to increase by 14 percent. Should this occur, it will be the largest percent increase in U.S. merchandise exports since 1973. Both the growth in the eight-country leading index and the decline in the dollar are contributing to this optimistic estimate.

The forecast changes in imports, which are based on growth rates in the U.S. leading index and in the real dollar exchange rate, were consistently higher than the actual changes in the early 1980's. More recently, however, just the opposite occurred. In 1986, for instance, imports were predicted to grow by 6 percent; the actual increas was 10 percent. The correlation coefficient shows that 72 percent of the variance in imports is related to these two factors. The 1987 prediction is that import volume will grow by 3 percent, well below the 10 percent growth in 1986.

The forecast levels of exports and imports that form the basis for the forecasts of the trade balance are obtained by multiplying the preceding year's actual levels by the forecast percent changes. The correlation coefficient shows that 92 percent of the movements in the trade balance has been picked up by the forecasts. In 1986, the trade deficit was 104 billion in 1977 dollars. The projection for 1987 on the basis of the forecast changes in exports and imports is a deficit of $93 billion, a reduction of $11 billion. This would be brought about by a much larger rise in exports ($19 billion) than in imports ($8 billion). For those who believe the appropriate objective for U.S. trade policy is balance between exports and imports, this suggests that some progress is being made but a very sizable problem still exists.

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The Conference Board, Inc.
845 Third Avenue
New York, New York 10022

The Conference Board, Inc.
Avenue Louise, 207-Bte 5
B-1050 Brussels, Belgium

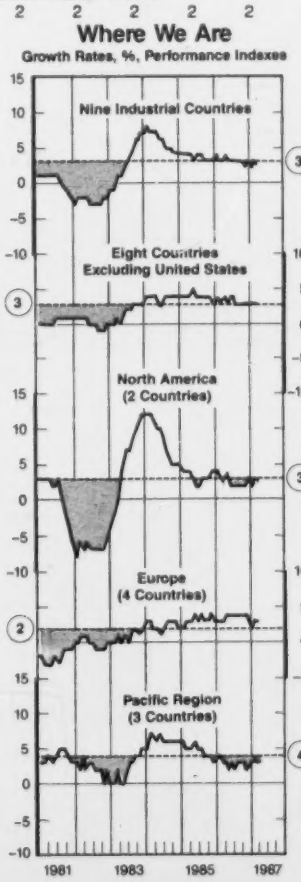
The Conference Board, Inc.
1755 Massachusetts Avenue, N.W.
Suite 312
Washington, D.C. 20036

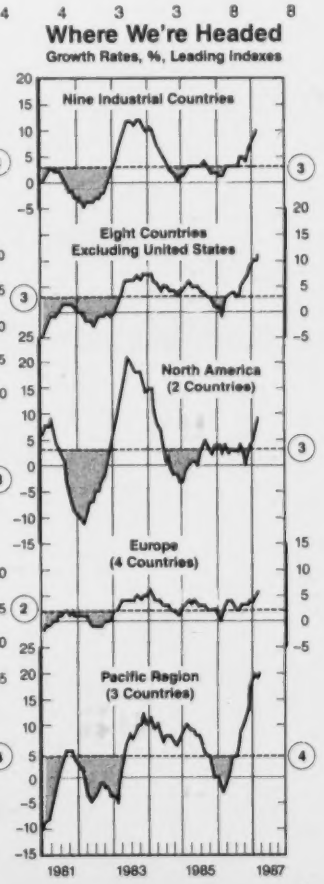
The Conference Board of Canada
255 Smyth Road, Suite 100
Ottawa, Ontario, K1H-8M7

INDEXES, NINE COUNTRIES, 1985-87

		U.S.		Canada		West Germany		France		U.K.		Italy		Japan		Australia		Taiwan, R.O.C.	
		Indexes, 1980 = 100																	
		Perf.	Lead.	Perf.	Lead.	Perf.	Lead.	Perf.	Lead.	Perf.	Lead.	Perf.	Lead.	Perf.	Lead.	Perf.	Lead.	Perf.	Lead.
Nov.	85	111	118	114	113	104	112	109	110	103	110	104	109	121	113	118	114	137	148
Dec.	85	112	120	115	114	104	111	108	109	103	111	104	110	122	113	118	113	138	150
Jan.	86	112	120	115	114	104	111	109	108	103	111	104	111	122	113	119	113	141	150
Feb.	86	112	121	116	115	104	110	109	107	103	111	105	111	122	111	118	112	143	152
Mar.	86	112	120	115	114	105	111	109	110	104	112	105	112	123	112	118	111	146	154
Apr.	86	113	121	116	115	107	112	110	113	104	111	105	114	123	114	119	113	144	156
May	86	112	120	116	114	106	112	110	115	104	111	106	115	123	115	120	114	145	157
June	86	112	121	116	114	107	112	111	114	104	111	105	114	123	116	121	115	148	159
July	86	113	122	116	115	108	111	112	114	104	112	106	113	123	116	119	114	149	161
Aug.	86	113	122	116	115	108	111	112	113	105	112	105	114	124	117	119	114	150	162
Sept.	86	113	123	116	115	108	111	112	115	105	113	106	115	124	119	120	116	152	163
Oct.	86	113	122	116	116	108	111	113	115	105	113	106	115	124	121	121	118	154	165
Nov.	86	113	121	116	114	108	112	113	116	106	113	106	116	124	124	120	119	155	168
Dec.	86	114	124	117	115	108	112	113	117	106	114	106	116	125	127	121	121	158	169
Jan.	87	114	125	117	117	108	113	113	117	106	114	106	116	126	130	121	121	159	169
Feb.	87	115	129	118	117	108	115	114	118	107	116		116	125	131	122	122	162	173
Mar.	87	114	128	118	117	108	116	114	118	107	117		117	125	134	122	124	158	174
Apr.	87	114	129			109			121									163	179
		Growth Rates, Percent																	
Nov.	85	3	2	5	4	4	4	4	2	4	–1	2	4	3	1	10	4	3	9
Dec.	85	3	4	5	3	3	2	3	1	4	1	1	6	3	–1	8	1	4	10
Jan.	86	4	4	6	3	4	1	3	–1	4	1	2	6	3	–1	9	0	8	9
Feb.	86	3	4	5	4	4	0	3	–3	4	0	2	6	3	–4	6	–3	9	11
Mar.	86	2	2	4	2	4	0	3	2	4	1	3	7	3	–3	6	–4	12	12
Apr.	86	4	4	5	3	6	2	4	6	4	0	2	9	2	0	6	–2	8	12
May	86	2	2	4	2	4	2	4	9	3	0	3	9	2	3	5	–1	9	12
June	86	2	3	3	1	6	1	4	6	3	1	2	7	2	4	6	1	9	13
July	86	2	3	2	2	6	0	5	6	3	1	2	5	2	5	2	0	11	13
Aug.	86	2	3	2	2	5	0	5	3	3	1	0	4	2	5	2	1	12	13
Sept.	86	2	4	2	2	5	0	5	6	3	3	2	5	3	9	2	4	13	12
Oct.	86	2	3	2	2	4	0	5	7	3	3	2	5	3	11	3	7	13	13
Nov.	86	2	0	1	0	4	1	4	6	4	3	2	5	2	14	1	8	13	14
Dec.	86	3	4	3	1	3	2	5	8	4	3	1	4	2	18	3	11	14	13
Jan.	87	1	5	2	4	2	3	3	6	3	4	1	3	4	22	2	10	13	11
Feb.	87	3	9	3	3	2	6	3	6	5	6		3	2	20	4	11	15	14
Mar.	87	2	9	3	3	1	6	3	6	4	8		4	2	22	4	12	9	13
Apr.	87	2	8			3			9									13	17
		Ten Year Annual Growth Rate, Percent																	
1976-86		3	3	3	3	2	2	2	2	2	2	2	2	4	4	3	3	8	8

		9 Countries		8 Countries ex. U.S.		North America (2)		Europe (4)		Pacific Region (3)	
		Indexes, 1980 = 100									
		Perf.	Lead.	Perf.	Lead.	Perf.	Lead.	Perf.	Lead.	Perf.	Lead.
Nov.	85	111	115	111	112	111	118	105	110	121	114
Dec.	85	111	115	111	112	112	120	105	110	122	114
Jan.	86	112	115	112	112	112	120	105	110	122	114
Feb.	86	112	115	112	111	112	120	106	110	122	113
Mar.	86	112	115	112	112	112	119	106	111	123	113
Apr.	86	113	117	113	113	113	121	107	112	123	115
May	86	113	117	113	114	112	120	107	113	123	116
June	86	113	117	113	114	112	121	107	113	124	117
July	86	113	117	114	114	113	121	108	112	123	118
Aug.	86	114	117	114	114	113	121	108	112	124	118
Sept.	86	114	119	114	116	114	122	108	113	124	120
Oct.	86	114	119	115	117	113	122	108	113	125	122
Nov.	86	114	119	115	118	114	121	109	114	124	124
Dec.	86	115	121	115	119	114	123	109	114	125	128
Jan.	87	115	122	115	120	114	124	109	115	126	131
Feb.	87	115	124	116	121	115	127	109	116	126	131
Mar.	87	115	125	116	123	115	128	109	117	126	134
		Growth Rates, Percent									
Nov.	85	3	2	4	2	3	2	4	2	3	1
Dec.	85	3	2	3	1	4	4	3	2	3	0
Jan.	86	4	2	4	1	4	4	3	1	4	0
Feb.	86	3	1	3	–1	3	4	3	0	3	–3
Mar.	86	3	1	3	1	3	2	3	2	3	–2
Apr.	86	4	3	4	3	4	4	4	4	3	1
May	86	3	3	3	4	3	2	4	4	2	3
June	86	3	3	3	4	2	3	4	3	3	4
July	86	3	3	3	3	2	3	4	2	2	4
Aug.	86	3	3	3	3	2	3	4	2	3	5
Sept.	86	3	5	3	5	2	4	4	3	3	9
Oct.	86	3	5	3	6	2	3	4	3	3	11
Nov.	86	2	4	3	7	2	0	4	3	2	13
Dec.	86	3	7	3	9	3	4	3	4	3	17
Jan.	87	2	8	3	10	2	5	2	4	4	20
Feb.	87	3	9	3	10	3	8	3	5	3	19
Mar.	87	2	10	3	11	2	9	3	6	3	20
		Ten Year Annual Growth Rate, Percent									
1976-86		3	3	3	3	3	3	2	2	4	4





Note: Horizontal dashed lines are average growth rates for 1976-86 in the index and in real GNP

Sources : Center for International Business Cycle Research and The Conference Board.